NEW PROSPECTS FOR AMERICAN CAPITAL—II

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In what way do the changes wrought by the Great War concern the investment of capital? In a former article I have endeavored to show that funds for investment will largely exceed normal savings during the next quarter to half-century. The total excess above normal which will come into the market during the period will probably exceed thirty-five billion dollars. If this enormous accumulation is to be utilized in a permanently beneficial way and is not to be squandered in fruitless undertakings, it will be necessary to alter radically the investing habits of the country, to educate the investor to an understanding of the new times and changed conditions, and, if possible, to guide the flow of capital into those lines which will work out to the greatest national profit.

There are six major fields for investment capital. The first to consider is foreign properties. By this I mean not securities indicating indebtedness, but actual ownerships, which by their nature have no term, though they may be bought and sold. The capitalists of this country may extend their control over the natural resources of foreign lands, particularly the unsettled regions susceptible to exploitation. They may secure concessions for railroads. They may erect engineering works, such as hydroelectric plants, for foreign countries requiring facilities but lacking capital. They may establish branches of American commercial and industrial institutions in other countries. They may even interest themselves in foreign industries. Doubtless much of this form of investment will take place. It is the channel into which England has directed her surplus capital through her favorable balance of trade in the past. But it must be noted that eventually income derived from these sources more than offsets

the annual export of capital entering this channel. England to-day has an amount of income from foreign investments sufficient to induce and to aid in accounting for an adverse trade balance.

There are many differences in the situation of England and America which make this a much less probable major field of investment for us. The British Empire is a support and an inducement to the exportation of capital. The Britisher is always within reach of his own Government. He has bases of operation in all parts of the world. Moreover, the very factors which have made the British a colonizing people, the limited size and resources of the "tight little isle", and the custom of primogeniture, have made it a national necessity to seek an outlet for their industrial energy and their surplus capital elsewhere. The development of England's world interests has been attended with wars of conquest, with methods of peaceful penetration, and with the active support of so-called "dollar diplomacy" even in lands of independent sovereignty. As we have found in Mexico, international ownerships bring entanglements that are involved neither in international loans nor in international trade. Since the necessity for foreign outlets for overflow capital and the facilities for this expansion provided by a world-wide empire do not exist in our case, and since the temper of our independent democracy seems opposed to the type of foreign relations that are a condition of this development, it is an open question whether American capital will seek extensive employment outside our borders. With the single exception of the ownership of natural resources, an inherent tendency of the great manufacturing corporations, which desire to control their own supplies of raw material, I doubt if the amount of ownerships acquired will, over a period of years, be an important factor in countering the payments due us.

The second outlet for capital lies in the purchase of foreign obligations, either for the purpose of funding new current commitments for purchases made here, or for refunding old debts. Issues of such securities have already been made upon a very large scale. Yet they have left unfunded a debt which probably exceeds all of the funded debts now in the hands of private owners. The drain upon such sources of private investment capital as are pre-

pared to enter foreign fields merely to fund for the time being the credits now extended by banks will be so great that it is a grave question whether any further extension of capital credits can be secured to cover temporarily the favorable trade balances that are still being created from day to day. It was the plan of those favoring the Edge law banks to finance further exports to Europe through bonds sold to the investor. Yet this fell through largely because it was perceived that it would merely build up further the topheavy balances owing us; did not contemplate, I believe, relieving the banking system of its large volume of almost frozen loans based upon commitments of foreign purchasers; and would only have served to enhance the problem which must eventually be faced, of receiving our payments in goods or placing in practically permanent form an international indebtedness which will be far larger than any hitherto known. Whatever we do now to finance a favorable balance of trade will to a large extent eventually increase our unfavorable balance of trade.

France has been a typical instance of an international banker of this variety. The French investor is legion. He is the petty bourgeois and the peasant as well as the capitalist. He invests through and upon the advice of his local banker. In the aggregate the funds accruing from these small individual sources are very large. But it is a matter of common knowledge in France that the direction which these funds have taken has not been entirely due to the choice and opinion of the individual investor, nor of his banker.

It is suggested that the inducement of buying the bonds of certain foreign governments on the basis of a high yield and placing them in the always receptive French market at its customary low rate, was so profitable that strong influence was brought to bear to assist in these foreign negotiations to the detriment of the needs for capital of local French institutions. Whether that is true or not, it is extraordinary that France should, to such a large degree, have lent, not used, its own surplus capital. And there is no similarity between the condition which has made it possible and the condition of vital and energetic development of indigenous industry which has been the characteristic of American finance.

Undoubtedly a large investment market for foreign bonds, government, municipal and private, has sprung into life during the war. And undoubtedly it will continue permanently as a large element in the investment field. Nevertheless, it is hopeless to try permanently to cover a balance of trade of fifteen to twenty billion dollars by this means. If this form of investment absorbs the renewals of existing foreign loans in the hands of individual investors it will do all that can reasonably be expected of it. It is at best but a small scale factor.

The third outlet for capital is our national plant for the production of goods—our own industrial machinery. During the war there has been poured into this plant vast quantities of new capital. Its capacity in many lines is far beyond the present demand, perhaps even beyond the peak demand of 1920. And it is now faced with totally new conditions. If I have proved that we must expect of necessity an adverse balance of trade, then in the aggregate our industrial plant will not need to meet even our own requirements, much less supply an exportable surplus. True, in many lines in which we are preëminent either by reason of natural advantages or greater efficiency, we should continue to be able to produce a surplus for export. But this in turn will correspondingly diminish the home outlet for other goods in which we must accept imports to balance these exports as well as the payments on indebtedness.

The fundamental test to be made upon all new capital issues for industrial purposes in the near future should be whether the line of manufacture is one in which we can naturally compete in world markets under adverse exchange conditions. If it is not, and the product is susceptible of international trading, then it will be in scarcely better position to compete in home markets. Perhaps appropriations of capital for increasing efficiency and lowering cost of production may pay and justify themselves by changing the position of the product in the market. But it is hardly possible that facilities which merely increase the output of such products will be profitable.

Tariff meddling will radically alter the positions of different lines of production in this respect. But what it does to help one or more lines will of necessity hinder others to an equivalent de-

gree. If we do not import so much of those articles which it is natural for us to import, we shall export less or import more of those which it is unnatural for us to import, or which we normally export. Therefore, the investor must take careful account of the indirect as well as the direct effect of our protective tariff schedules. Under the new conditions our strong industries will suffer for whatever protection is given the weak ones.

There may be a question in the minds of some as to whether Europe will ever again be in position to undersell us because of lower cost of production. To them I bring this consideration: In the long run it is evident that the economic pressure upon the peoples of Europe who have depended upon the exchange of their manufactured goods for foreign food supplies will, through sheer inability to feed their people otherwise, force a lower standard of living and the synonymous low wage scale. This will create a condition in which with present facilities they can and will undersell us in lines where labor is the principal element of the cost of production. Gradually the extraordinary pressure of competition for food will be relieved by emigration and a lowered birth rate. But all social forces, encouraged by modern doctrine, will be striving for relief from this pressure and will doubtless have the effect of giving to labor a larger and to capital a smaller share of the return than is normal. This will result in reduced accumulation of capital which will cause Europe to hang behind us in the process of the development of industrial efficiency and the substitution of machinery for men in industry, which can only be accomplished by new increments of capital. Our own policy should then be to meet this temporary but weakening competition with capital expenditures looking toward lowered costs of production. The tendency will be for America to make progress and for Europe to retrograde in the field of industrial efficiency and mechanization.

The fourth outlet for capital is in agriculture and the production of raw materials. It is a new phenomenon in the industrial age of the world that the country which is greatest in manufactures should also be so nearly self-sufficient as regards its food supply and its basic raw materials. And for this reason there is no precedent by which to foretell the character of our further

economic development. The sudden growth of the population of Europe during the nineteenth century, when England's people increased fourfold, Germany's threefold and the population of the continent as a whole doubled, was made possible by the settlement, principally by emigrants, of huge new food and material producing areas in other parts of the world. This settlement and the coincident improvement and cheapening of methods of transportation provided at one and the same time a source of food and materials to support this vast additional home population and a new and greater market among the colonists for the manufactured product. Agriculturally, Europe was no longer self-supporting. In England there was an actual decline in agricultural output largely due to the competition of cheaper and more fertile land.

The origin of our huge modern international trade lay in the conversion of nearly all Western Europe into the classic economist's "town", producing goods for and living upon the surrounding "country"—the rest of the world.

That time is past. The "country" is developing its own "towns". It is rapidly becoming self-sufficient. The newly settled agricultural areas are bringing in their wake industrial cities. And in this change the United States is merely the first to arrive at a stage of self-sufficiency. Everywhere the change is in progress. Perhaps, or probably, this means that the days of great international trade in food versus manufactures may be drawing to a close; that as each new land develops its industry, each old land must revive its agriculture. At any rate, the development of Europe's international trade is no criterion to us who require little or no food and only certain materials. We cannot sell abroad unless we buy abroad at least to an equal extent. But must we take food which we do not need in trade for manufactured products because Europe has done so?

The line of division between the agricultural interests and the industrial interests of this country will be sharply drawn during the next few decades. Without governmental interference certain staple goods in which we have no advantage will tend to enter largely into our imports to equalize exports of manufactured products and raw materials in which we do have an advantage. This was the process that crippled England's agriculture. It threat-

ens here. But the great political power of our agricultural interests and perhaps a general sense of national welfare may encourage the powers that be to reverse the old rule and give protection to agriculture while withdrawing it from industry. It would be futile to try to give it to both. If this is done the price level for foods in this country will be higher than elsewhere and our agricultural output will sooner than otherwise arrive at the point where there is no exportable surplus. For there would naturally be a change in the character of our crops to effect a curtailment of those in which the surplus would need to be "dumped". But in other respects such a policy will serve merely to maintain agriculture in the *status quo*, and the most fertile source of the farmer's profits, speculation in the price of land, will as a result be largely eliminated.

Even should the protection which is now promised not materialize, we should not be apt to see a rapid decline in agriculture. It would be a slow process, coming about only as our virgin soils became exhausted below the fertility of the poorest of those foreign areas which are required to complete the food supply of the world. Then, too, there is always some margin due to the cost of transportation, though wheat was moved from Chicago to Liverpool in 1905 for only 9.7 cents a bushel. And there is some advantage accruing to our farmers in superior technique and skill. Scientific farming, inventiveness in labor-saving machinery and a comparatively ample supply of capital may keep our farmer in a position where he can compete at least in our home markets in spite of the pressure to import his products.

It is obvious from these considerations that agriculture will be at a natural disadvantage; that merely to retain its modicum of prosperity may require protection; and that in the future it will be a far less attractive field for investment than it has been in the past.

I have treated of these five fields of investment merely to show that while they will undoubtedly continue to absorb large quantities of new capital, conditions in the near future will be far less favorable to them than they have been in the recent past. Foreign investments will be induced, it is true. But they are not likely to absorb a great portion of our annual increment of new

capital. And if through force of habit this increment flows into the channels of general industry and agriculture, it will not be likely to yield a return either satisfactory to the individual or conducive to national prosperity.

But there are two other fields to which I wish to direct special attention, for they seem, under the new conditions, to be the ideal types of investment.

Of these the first is the production of new commodities or means for the satisfaction of new human wants; devices attainable to the generality of men, for which the market will be additional to all present demand. Instead of devoting the increase of manufacturing energy to competing for the limited demand for old products, instead of pouring more goods into already saturated markets, it is quite possible to develop additions to the standard of living for which a new demand will spring up. We have already done much of this. The automobile, the phonograph, the moving picture and the sewing machine are examples which come to mind. These articles were not to any large degree replacements. They were new products. Their development has caused concern among those who conceived them as evidences of national extravagance. They did not perceive that the creation of anything that is wanted creates at the same time the purchasing power to pay for it. Surplus economic energy can find no better employment than in addition to the equipment of the consumer. If part of our population can make enough of the natural home commodities to supply all of us and maintain our desirable exports, then the rest can much better contribute new articles to the general welfare than either to over-produce in lines already saturated, or attempt to provide those things which the rest of the world is ready to give us in payment for our exports and their debt.

Material progress is associated with an improving standard of living and the goal is a happier and more progressive people. Mere quantity of production—mere productivity—is an outworn fetish. New kinds of production, the development and exploitation of new inventions, should be encouraged and receive more general financial backing. If successful, these ventures are always the most profitable. One feels that he is not talking into deaf ears when he preaches this doctrine to Americans.

The last field of investment is decidedly the largest of all and is the one *par excellence* which under present conditions should receive the great bulk of new capital. This is the fixed capital devoted to the production of services to our people as distinguished from the production of commodities. It consists principally of public works, public utilities and housing. At least half of the total invested capital of the United States is at the present time included in this classification.

This is a crude new land. Away from the relatively narrow limits of industrial settlements the face of nature has been little touched. The country is still frontier by comparison with the man-made countryside of older and more thickly settled Europe. We have been too busy with our beginnings to develop, in the short space of a hundred years, the finished product of a land arranged for man. We need waterways, hydro-electric developments, reforestation, roads and even parks. But public works are not developed on the initiative of private capital, though they are commonly financed by municipal bonds. Undoubtedly these projects can and will use large quantities of our savings, and officials should be encouraged to make wise expenditures for these purposes. As long as such bonds remain tax-free there will need to be no further incentive to secure all the capital that can safely be used for this purpose.

With the public utilities the case is, of course, different. They have been starved for ten years and are far behind their normal development. This is particularly true of the railroads, but somewhat true of other classes as well. With the coming of lower costs and saner regulation it is to be hoped that the credit of the public utilities in the market place may be reëstablished, so that they can secure a large share of the new capital available for investment, increase their facilities, and improve their efficiency both by the introduction of new devices and the judicious replacement of old.

Finally, there is the housing problem. And this field I particularly wish to emphasize because, while it is the largest single type of investment of the people as a whole, it has been singularly and perhaps unfortunately free from the application of funds upon a wholesale scale. It is an enormous and ideal field for investment,

particularly favored under the new conditions. Yet it has been, and is now, left largely to individual and retail handling.

Our housing is not nearly sufficient, nor suitable to the requirements or means of our people. The buildings are not permanent as in Europe, but are too generally cheap, temporary structures, because they are built as "tax-payers" or on the very limited means of the home-builder. The business of erection and of financing the homes of the people is usually handled on a small local scale. There is no open market for mortgages on residence property. These are matters for individual transaction, privately arranged. And the result is that investment in first and second mortgage loans and the ownership of renting residence property is so troublesome that the average investor cannot be tempted to touch it. Perhaps one of the reasons for the development of the apartment house has been the readiness with which it lent itself to a more business-like and large-scale handling.

As a general rule housing has not been considered a field for big financial operations. Some of the Western trust companies are already engaged in the residence mortgage business. The savings banks and insurance companies invest extensively in first mortgages on such buildings. But there is need for big operating and big financing corporations to develop this field. The risk of loans on standard housing developments is far less than upon specialty or one-use buildings, and the profits are big. A system of bond issues based on mortgages on assorted risks could undoubtedly be made a success.

It is, of course, utterly foolish that the outcry against the profiteering landlord should be permitted to take the course of harassing and restrictive legislation. What is needed is legislative encouragement and popular favor so as to attract investors into this field, not to drive them out as is now being done. Proposed federal legislation seems to indicate a change of sentiment in this regard.

It is also necessary that costs should come down. But that is coming at once. Material costs are already well liquidated and the reduction of wages is on the way. Labor must be satisfied with an equal real wage, and the money wage must come down, as it advanced, with the cost of living. The closed shop in the

building trades should be broken up, for it has been the bane of the business, and has permitted a small group of labor-monopolists to squeeze the rest of the people unmercifully. Yet even the laborers have not gained commensurately with what others have lost, because most of the increased cost has arisen through the lowering of output from restrictive rules and ancient methods. Since half of the cost of ordinary building is in direct labor and the bulk of the material cost is in indirect labor, a revolutionary increase in efficiency and a moderate reduction of wages would decrease building costs to somewhere between one-third and one-half of their present level.

In this last class of investment, which comprises most of the plant for the production of services to the people, there can be no competition from abroad. Europe can pay her debts to us in goods in the form of an adverse trade balance, while we devote the industrial energy thus saved to making ourselves more comfortable in our home land. Imports of goods indirectly liquidating the foreign debts will become new capital in the hands of some American, and will be released for reinvestment here. These funds should be reinvested in the form which will procure for the investor the greatest security and the largest return. Naturally these purposes will be best served, not by investment in some overcrowded field to increase production and compete with other redundant products for a limited foreign or domestic demand, but rather in the less competitive fields, in the manufacture of new kinds of goods and the enlargement or improvement of our equipment of permanent property for the production of direct services to our people. Because such undertakings offer a greater security and profit they will result in greater and more substantial prosperity among both groups concerned, the capitalists and the workers, and indirectly react to the benefit of the people as a whole.

Masses of men move according to natural laws. The causes of their actions are to be found in the conditions out of which they spring. It is my belief that the policies and choices which I have described will be followed, not so much voluntarily as involuntarily. They seem to be on the cards. As a people we are more likely to engage our attention in elevating our standard of living

at home than in spreading out to cover the world with our ownership and trade. If this is true, it is not well to attempt to stem the current. It is better to choose the winning, not the losing, side. The international banker has his place. And it will be a place of increasing importance. But the business of finding funds for public utilities and for housing will have a far greater development.

The careers of England and of France are not criteria for the United States. History does not repeat itself in the same terms at different times and under different conditions. The era of American preëminence may show to the world a new road to and a new standard of prosperity; a prosperity not so much built upon the quantitative increase of trade and industry as upon the invention and development of improvements and additions to the means of material welfare. Progress may consist in the development of new wants quite as well as in the readier gratification of the old.

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